

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition :  
of :  
COMMACK FISH & SEAFOOD :  
RESTAURANT CORP. :  
for Revision of a Determination or for Refund :  
of Sales and Use Taxes under Articles 28 and 29 :  
of the Tax Law for the Period June 1, 1984 :  
through May 31, 1987. :

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In the Matter of the Petition :  
of :  
ANTHONY ANNUNZIATO, OFFICER OF :  
COMMACK FISH & SEAFOOD :  
RESTAURANT CORP. :  
for Revision of a Determination or for Refund :  
of Sales and Use Taxes under Articles 28 and 29 :  
of the Tax Law for the Period June 1, 1984 :  
through May 31, 1987. :

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:DETERMINATION

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In the Matter of the Petition :  
of :  
KATHLEEN ANNUNZIATO, OFFICER OF :  
COMMACK FISH & SEAFOOD :  
RESTAURANT CORP. :  
for Revision of a Determination or for Refund :  
of Sales and Use Taxes under Articles 28 and 29 :  
of the Tax Law for the Period June 1, 1984 :  
through May 31, 1987. :

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Petitioners, Anthony Annunziato, Kathleen Annunziato and Commack Fish & Seafood Restaurant Corp., 116 Commack Road, Commack, New York 11725, filed petitions for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period June 1, 1984 through May 31, 1987 (File Nos. 806457, 806458 and 806459).

A consolidated hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on May 9, 1990 at 9:45 A.M. Petitioners appeared by Douglas A. Durnin, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Irwin A. Levy, Esq., of counsel).

### ISSUE

Whether the Division of Taxation correctly determined the amount of sales and use taxes due.

### FINDINGS OF FACT

Petitioner Commack Fish & Seafood Restaurant Corp. (the "restaurant") was an establishment comprised of two departments. On one side of the restaurant, petitioners sold raw fish. This side contained lobster tanks and a case for the display of fish. The restaurant sold prepared food on the other side of the store. This department contained 14 tables located in close proximity to each other.

There was a separate cash register for each side of the restaurant. The restaurant was open six days a week and had two or three waiters or waitresses working on the premises.

In 1984, the restaurant sold prepared food two days a week. In 1985, the restaurant sold prepared food three days a week, and in 1986 sales of prepared food increased to four days a week. In 1987, the restaurant sold prepared food six days a week.

Petitioner Anthony Annunziato purchased the restaurant in 1981 for \$75,000.00. At that time, he paid \$15,000.00 in cash and borrowed the balance. During the period in issue, the outstanding stock of the restaurant was held by Anthony Annunziato and Kathleen Annunziato. Anthony Annunziato served as president of the corporation and Kathleen Annunziato was the corporation's vice-president and secretary.

In a letter dated January 14, 1987, the Division of Taxation advised the restaurant that it was planning an examination of the restaurant's sales tax returns. The letter requested that petitioners make available all books and records pertaining to the restaurant's sales tax liability during the period of the audit, including journals, ledgers, sales invoices, purchase invoices,

cash register tapes and exemption certificates.

After the foregoing letter was sent, the Division made an appointment with the restaurant's accountant to examine the books and records. During the meeting which followed, some records were made available for examination such as a ledger of cash receipts for 1984, 1985 and 1986. Some records for 1987 were also presented. However, the auditor learned that, as of the date of that meeting, the cash receipts journal had not been prepared for 1987 and that petitioners did not retain their guest checks or cash register tapes.

In order to calculate the amount of sales and use taxes due, the Division decided to conduct an observation test. On Friday, June 12, 1987, an auditor positioned herself near one of the restaurant's cash registers and recorded the restaurant's sales from 11:00 A.M. until 7:30 P.M. During this period of time, the Division observed taxable sales of \$2,048.00. The Division then divided this amount by petitioners' average taxable receipts per books of \$526.00 on Fridays during June, July and August of 1986 in order to calculate an error rate of 289.35%. The reported taxable sales during the audit period were then multiplied by the error rate resulting in audited taxable sales of \$515,188.00. This amount was then reduced by reported taxable sales during the audit period of \$132,320.00 resulting in additional sales subject to sales and use tax of \$382,868.00.

The Division also found that, as of July 5, 1985, the restaurant did not pay tax on its gas and electric utility bills. An engineer's report, which was made available to the Division, concluded that 75% of the electricity was used for production. The Division accepted this percentage and determined that tax was due on 25% of the electric utility bills. It also determined that tax was due on 100% of the gas utility bills for the period June 1, 1984 through May 31, 1987.

On the basis of the foregoing audit, the Division issued two notices of determination and demands for payment of sales and use taxes due, dated September 18, 1987, to the restaurant. The first notice assessed sales and use taxes for the period June 1, 1984 through May 31, 1987 in the amount of \$29,124.22, plus penalty of \$4,967.10 and interest of \$5,044.88, for a total

amount due of \$39,136.20. The second notice assessed a penalty pursuant to Tax Law § 1145 in the amount of \$2,303.02.

The Division also issued notices of determination and demands for payment of sales and use taxes due to Anthony Annunziato and Kathleen Annunziato, as officers of the restaurant. These notices, which were also dated September 18, 1987, assessed the same amount of tax, penalty and interest which had been assessed against the restaurant. The notices which assessed tax explained that the individual petitioners were liable as responsible officers of the restaurant pursuant to sections 1131(1) and 1133 of the Tax Law.

After the assessments were issued, a conference was held wherein petitioners presented the restaurant's cash receipts journal for the period February 1987 through June 1987. Using those records, petitioners' taxable receipts on Fridays during the period February 1, 1987 through May 31, 1987 were totalled and then divided by the number of Fridays in that period to calculate average taxable receipts of \$612.00. The average taxable receipts were then divided by \$1,933.00, the sales on June 12, 1987 per petitioners' books, to calculate an error ratio of 215.85%. On the basis of the revised error ratio, the additional tax due on petitioners' taxable sales was reduced to \$21,342.86.

After the audit was conducted, petitioners complained that the assessment was too great because the audit methodology did not take into account the fact that petitioners had expanded the kitchen. The Division chose not to give this argument any credence because petitioners were unable to show that they had increased the number of tables available for serving customers after the renovation and because the Division did not observe a marked increase in utility usage.

Mr. Annunziato left school at the age of 14 and, at the time of the audit, he did not know how to read or write.

Mr. Annunziato did know how to write numbers and how to add. In 1984, he kept the records for the store. In practice, Mr. Annunziato used his cash registers to obtain a total of the sales of fresh fish and prepared food. These amounts were then recorded in a black notebook.

Once a month, Mr. Annunziato gave the notebook to his accountant and, when the accountant was finished with the notebook, it was returned to Mr. Annunziato. At the end of the year, when Mr. Annunziato was finished with the notebook, he gave the book to his children as a scribbling pad. Mr. Annunziato's accountant never told him to save the notebook or cash register tapes and Mr. Annunziato did not realize that it was necessary to save these items.

Early in 1987, petitioners remodeled the kitchen by installing a broiler and a steam table. The restaurant also stopped using disposable plastic dishes and began using dishes which were reusable. Prepared food sales increased after the renovations.

It is petitioners' experience that on warm days the sales of prepared food increased. Similarly, sales of prepared food increased during the warmer periods of the year. Fresh fish sales declined as prepared food sales increased.

The Friday on which the observation test was conducted was a sunny, hot day and the restaurant was busier than normal.

In 1986, the restaurant's records were maintained by Mrs. Annunziato. It was Mrs. Annunziato's practice to record the sales figures obtained from the cash register in a notebook. At the end of a week, the figures were placed in a ledger. Once a month, the sales figures were given to an accountant for the preparation of sales tax returns. The sales and use tax returns, which were subsequently prepared by the accountant, were reviewed by Mrs. Annunziato and signed by Mr. Annunziato.

The increase in prepared food sales during the audit period was not reflected in marked increased electricity usage because petitioners began trying to save electricity by shutting down their compressor and buying better equipment.

According to the restaurant's records, sales of prepared food during the period February 1987 through June 1987 were as follows:

February	\$ 7,880.00
March	8,477.00
April	8,258.00
May	8,808.00
June	15,314.00

According to the restaurant's records, sales of prepared food on Fridays during June 1987 were as follows:

June 5, 1987	\$1,248.00
June 12, 1987	1,933.00
June 19, 1987	1,677.00
June 26, 1987	1,698.00

#### SUMMARY OF PETITIONERS' POSITION

It is petitioners' position that the selection of a Friday to conduct the observation test resulted in an error rate that was inappropriately high. Petitioners also argue that the audit does not take into account that renovations resulted in increased prepared food sales during the last portion of the audit period. Lastly, petitioners argued that the error rate was too great because the observation test was conducted on a warm day with a concomitant increase in sales.

#### CONCLUSIONS OF LAW

A. As vendors of prepared foods, petitioners were required to collect sales tax on their sales of such prepared foods (Tax Law §§ 1105[d][i]; 1132[a]). Petitioners were also required to keep a record of every sale and the tax due thereon, including "a true copy of each sales slip, invoice, receipt, statement or memorandum" (Tax Law § 1135[a]). When a taxpayer fails to keep records of every sale as required by Tax Law § 1135, the Division is authorized by Tax Law § 1138 to estimate the amount of tax due on the basis of external indices (Matter of Licata v. Chu, 64 NY2d 873, 487 NYS2d 552).

B. In determining the amount of sales tax liability, it is the duty of the Division to select a method "reasonably calculated to reflect the taxes due" (see, Matter of Grant Co. v. Joseph, 2 NY2d 196, 159 NYS2d 150, 157, cert denied 355 US 869). When the Division employs such a method, it becomes incumbent upon the petitioner to establish error (Matter of Meyer v. State Tax Commn., 61 AD2d 223, 402 NYS2d 74, lv denied 44 NY2d 645, 406 NYS2d 1025). Furthermore, accuracy in determining the amount of tax due is not required when it is the petitioner's failure to maintain the proper records which prevents it (Matter of Markowitz v. State Tax Commn., 54 AD2d 1023, 388 NYS2d 176, affd 44 NY2d 684, 405 NYS2d 454).

C. Petitioners have not disputed that use of external indices was proper. However, they

maintain that the audit method employed resulted in an incorrect determination of the amount of tax due.

First, petitioners contend that an excessive amount of tax was determined because a Friday was selected as the day on which to conduct an observation test. This argument is without merit. It is certainly plausible, as petitioners contend, to expect the sale of fish to be greater on Fridays than other days of the week. However, since the error rate was calculated by comparing a Friday with other Fridays, there is no basis to conclude that the calculation resulted in an erroneous error rate or that this aspect of the audit methodology was unreasonable.

Petitioners' second argument is that the audit methodology was erroneous because it failed to take into account renovations to the restaurant. This argument is also without merit. The calculation of the error rate, as modified at conference, did not use any sales information from any periods prior to the renovation of the restaurant. Therefore, the renovations have no bearing on the revised audit methodology.

D. Petitioners' last argument is that the particular day selected to conduct the observation test was warm enough to result in a higher level of prepared food sales than would normally occur on a Friday. Therefore, it is argued that an erroneous error rate was determined.

Before considering this argument, it is necessary to address an apparent flaw in the way the Division made its post-assessment adjustment to the notices. When an observation test is conducted, calculations are performed in order to make a comparison between the taxable sales occurring during the period of the observation and those sales shown on the firm's sales and use tax returns (see, e.g., Matter of Mera Delicatessen, Inc. and Emil Mekhail, as Officer, Tax Appeals Tribunal, November 2, 1989; Matter of Gaetano Vendra d/b/a Pete's Pizzeria, Tax Appeals Tribunal, February 9, 1989). In this instance, when the Division revised its audit, it compared the sales shown on the restaurant's records on June 12, 1987 to the sales shown on the restaurant's records on Fridays during the period February 1987 through May 1987. Not only did this calculation ignore the observation test, it assumes that the level of sales are consistent for each month during the audit period.

Petitioners have established that the level of prepared food sales generally increases as the weather becomes warmer.<sup>1</sup> Therefore, comparing the sales of a warm day in June with an average of a day during the months of February, March, April and May results in an improperly inflated error rate. On the basis of the foregoing, the Division is directed to recompute the error rate by comparing the taxable sales found during the observation

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<sup>1</sup>It is noted that the original audit computation implicitly accepted this premise by using the months of June, July and August 1986 in the audit.



test to the prepared food sales on Fridays during the month of June 1987.<sup>2</sup> In reaching this conclusion, no effect has been given to petitioners' claim that sales were 30% higher on warm days. While the restaurant's records show that sales did increase during warm periods, it is not possible to discern from the restaurant's records that they increased to the extent stated. The averaging used here should minimize the distortion caused by conducting the observation on a warm day.

E. The petitions of Anthony Annunziato, Kathleen Annunziato and Commack Fish & Seafood Restaurant Corp. are granted to the extent of Conclusion of Law "D" and the Division is directed to modify the notices of determination and demands for payment of sales and use taxes due accordingly; except as so granted, the notices are, in all other respects, sustained.

DATED: Troy, New York

ADMINISTRATIVE LAW JUDGE

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<sup>2</sup> Percentage Increase in Taxable Sales Reported

Taxable sales during observation test		\$2,048.00
Less: Average Friday taxable sales, June 1987	<u>1,639.00</u>	
Remainder		\$ 409.00

Difference =  $\frac{\$ 409}{\$ 1,639} = 24.95\%$  error rate  
Average Friday Taxable Sales in June 1987